

**STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE  
45 Fremont Street, 24th Floor  
San Francisco, California 94105**

**INITIAL STATEMENT OF REASONS**

**Date: August 21, 2009**

**REG-2009-00019**

**LIMITATION ON UNDERWRITTEN TITLE COMPANY LIABILITY**

**INTRODUCTION**

Title insurers and underwritten title companies perform different but symbiotic functions in the title marketplace. Underwritten title companies perform title searches upon which title insurance policies are written, and also title related escrow services if specifically licensed for that purpose. Title insurers indemnify property owners and others for title related losses by issuing insurance policies and may perform title related escrow services. A title insurer can act on a direct basis without the use of an underwritten title company, but an underwritten title company may only transact business if it is in contract with a title insurer. These contracts between the title insurer and the underwritten title company are generally known as underwriting agreements. Underwriting agreements delineate the business relationship between title insurers and underwritten title companies. As a result of the underwritten title company needing a title insurer to operate, the parties to the underwriting agreement, the title insurer and the underwritten title company, are not equals and the underwriting agreement provisions which control the operations of the underwritten title company may be economically disadvantageous to the underwritten title companies.

The purpose of the proposed action is to enact a long standing position of the California Department of Insurance ("CDI") to limit the liability of underwritten title companies to indemnify title insurers to five thousand dollars (\$5,000) with some specific exceptions for intentional, willful acts and escrow related losses, which limitation fosters the solvency of underwritten title companies. Further, the proposed action limits the liability that may be transferred from the title insurer, that is generally more highly capitalized and able to bear the loss, to the underwritten title company agent that is generally less able to bear the loss. The proposed action also creates an incentive for underwritten title companies to use a duty of care by permitting the transfer of some risk to underwritten title companies.

Towards the achievement of that goal, the proposed regulation establishes the limitations on risk transfer between title insurers and underwritten title companies that may be agreed to by contract.

The Commissioner believes these proposed regulations are reasonably necessary to carry out the purpose of the Underwritten Title Company statute, namely to promote the regulation of the business of title insurance, to facilitate new market entry, to promote California small businesses,

to provide for proper risk bearing amongst the licensed entities, to facilitate fair dealing, prevent fraud and promote fair claims practices for California consumers of title insurance and to promote the alignment of risk assumed with capital requirements amongst the licensed entities. Further, the proposed regulations will clarify expectations for compliance by title insurers and underwritten title companies with the permitted liability transfer or risk shifting in their underwriting agreements. The proposed regulation is reasonably necessary to achieve regulatory compliance in this area.

## **SPECIFIC PURPOSE AND REASONABLE NECESSITY OF EACH REGULATION**

The specific purposes of proposed adoption and the rationale for the Commissioner's determination that the adoption is reasonably necessary to carry out the purposes for which it is proposed are set forth below.

Proposal to adopt a new Article 14 "Underwritten Title Companies" and to adopt a Section 2194.70 entitled "Underwritten Title Company Limitation on Liability" of Title 10, chapter 5, subchapter 1 of the California Code of Regulations.

New regulatory section 2194.70 states that no contract between a title insurer and an underwritten title company shall provide for indemnity of the title insurer by the underwritten title company in excess of five thousand dollars (\$5,000) of loss per policy. This section is reasonably necessary to establish the limitations on underwritten title company liability upon which underwritten title companies may conduct business. Further, this proposed new regulation will continue the longstanding CDI requirement that limits risk shifting between the licensed underwritten title companies and their title insurers. This regulation will create an incentive for underwritten title companies to perform their functions carefully and diligently.

This regulation will also provide an exception for losses that are caused by willful or intentional acts of the underwritten title company or its employees, and clarify that such losses may be indemnified by contract in excess of five thousand dollars (\$5,000) per policy. This section is reasonably necessary to establish the limitations on underwritten title company liability upon which underwritten title companies may conduct business. This exception will follow California law and permit insurers to recover for intentional and willful acts of their underwritten title companies.

This regulation will in addition define the terms "loss" to include title losses and any other business of title insurance losses caused by the underwritten title company's operations but shall not include escrow losses. This definition is reasonably necessary to establish the limitations on underwritten title company liability upon which underwritten title companies may conduct business. Further this definition will clarify that escrow losses are not included within the regulation liability limitation.

This regulation will in addition define the term "contract" to include "underwriting agreement." This definition is reasonably necessary to establish the limitations on underwritten title company liability upon which underwritten title companies may conduct business. By defining the word contract to include underwriting agreements, title insurers and underwritten title companies will

not be permitted to use other contracts to shift additional liability in excess of the five thousand dollar (\$5,000) limit.

As the regulation clarifies and makes specific the Underwritten Title Company statute and related statutes, this section is reasonably necessary to regulate the conduct of underwritten title companies and their title insurers.

## **IDENTIFICATION OF STUDIES AND OTHER INFORMATION**

The Commissioner has identified the following studies, reports, testimony, and other documents relied upon in proposing the adoption of these regulations:

1. Title Insurance Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers United States Government Accountability Office (GAO) Report to the Ranking Member , Committee on Financial Services, House of Representatives April, 2007;
2. Title Insurance Preliminary Views and Issues for Further Study, Statement of Orice M. Williams, Director Markets and Community Investment, United States Government Accountability Office (GAO) Testimony Before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives, April 26, 2006;
3. Title Insurance Preliminary Views and Issues for Further Study, United States Government Accountability Office (GAO) Report to the Chairman, Committee on Financial Services, House of Representatives, April, 2006;
4. Report to the California Insurance Commissioner, An Analysis of Competition in the California Title Insurance and Escrow Industry Birny Birnbaum, Consulting Economist, December, 2005;
5. Insurance Organizations Authorized in California 2006 publication of the California Department of Insurance;
6. Analysis of California Licensed Title Insurers' Direct Written Premium, Market Share, and Herfindahl-Hirschman Index ("HHI") for year 1993 through 2008, prepared by Rate Specialist Bureau-07/27/2009; and
7. Analysis of California Licensed Title Insurers' Direct Earned Premium, Direct Incurred Losses and Loss Ratio for years 1993 through 2008, prepared by Rate Specialist Bureau-07/27/2009.

## **SPECIFIC TECHNOLOGIES OR EQUIPMENT**

Adoption of these regulations would not mandate the use of specific technologies or equipment.

## **ALTERNATIVES**

The Commissioner has determined that no reasonable alternative exists to carry out the purposes for which these regulations are proposed.

## **ECONOMIC IMPACT ON SMALL BUSINESS**

The Commissioner has identified no reasonable alternatives to the presently proposed regulations, nor have any such alternatives otherwise been identified and brought to the attention of the Department, that would lessen any impact on small business. Also, the Commissioner has reason to believe that limiting the liability of underwritten title companies will serve to preserve and enhance the opportunities for small business formation and entry into the title market

## **PRENOTICE DISCUSSIONS**

The Commissioner has not conducted prenotice public discussions pursuant to Government Code Section 11346.45, because given the number of years the limitation on liability guideline has been in place, the many affected parties who would have been invited to participate in such discussions — primarily title insurers and underwritten title companies — are unlikely to find the proposed regulations too complex or multifaceted to be reviewed easily during the comment period.